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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

In the Matter of	)	
	)	
1998 Biennial Regulatory Review –	)	IB Docket
Reform of the International Settlements	)	No. 98-148
Policy and Associated Filing Requirements	)	
	)	
Regulation of International	)	CC Docket No. 90-337
Accounting Rates	)	

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COMMENTS OF AT&T CORP.

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TABLE OF CONTENTS

SUMMARY

AT&T welcomes the Commission's review of its international settlements policies in light of recent changes in the global marketplace. AT&T agrees with the Notice that the ISP should be removed for arrangements with foreign carriers that lack market power and where foreign markets are sufficiently competitive to prevent harm to the U.S. public interest. Such a move would serve the interests of U.S. consumers and carriers by encouraging lower rates and new services.

The Commission should continue the ISP where there has been no meaningful change in competitive conditions and the existing or former foreign monopoly carrier can still whipsaw competing U.S. carriers. Reliance on non-existent or highly imperfect market forces cannot substitute for the Commission's proven regulatory policies in protecting the interests of U.S. consumers and carriers against the abuse of foreign market power. In particular, AT&T is concerned by the proposal to remove the ISP for arrangements with foreign dominant carriers on routes where ISR may be authorized by the Commission but not necessarily allowed in the foreign market.

To remove the ISP with foreign dominant carriers where U.S. carriers cannot, in practice, engage in ISR would encourage whipsaws and prevent settlement rates from being reduced below benchmarks to cost-based levels. The Commission should require instead either settlement rates at "best practice" levels, or the ability of U.S. carriers to terminate traffic in the foreign market through viable ISR arrangements.

AT&T is also concerned by the proposal to modify the Commission's flexibility policy in ways that would increase the adverse effects of the arbitrary restrictions already imposed on 25 percent and above flexibility arrangements and provide

new whipsaw opportunities to dominant foreign carriers. There is no justification for secret below-25 percent flexibility arrangements -- allowing some U.S. carriers to keep their arrangements with dominant foreign carriers on flexibility routes entirely secret -- while AT&T's arrangements for more than half its traffic on those routes would remain subject to full public disclosure and regulatory review. Because AT&T lacks market power, as the Commission found in 1996, this proposal would be harmful to competition, as demonstrated by the attached affidavit by Dr. William Lehr, and should not be adopted. For the same reason, the different treatment of above- and below-25 percent flexibility arrangements should be eliminated.

The Commission should retain its existing ISR rules and should not adopt the proposals to lift these rules entirely at some future point and to allow "limited" ISR on all routes immediately. Such an approach would do little or nothing to lower settlement rates and would merely be an invitation to one-way bypass. The present reporting safeguards remain untried, and are likely to be rendered largely ineffective by the removal of the traffic distinctions on which they depend with the removal of the ISP.

Finally, the Commission should prohibit the geographic grooming of inbound traffic in foreign carrier arrangements with the Bell Operating Companies. Unlike the 25 percent flexibility restriction, which disproportionately affects AT&T notwithstanding its lack of market power, grooming restrictions on the BOCs prevent the leveraging of their control of bottleneck facilities in the U.S. market and are necessary to prevent competitive harm.

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
1998 Biennial Regulatory Review – Reform of the International Settlements Policy and Associated Filing Requirements	)	IB Docket No. 98-148
	)	
Regulation of International Accounting Rates	)	CC Docket No. 90-337

COMMENTS OF AT&T CORP.

AT&T Corp. ("AT&T") hereby submits its Comments in response to the Notice of Proposed Rulemaking[1] concerning the Commission's proposals to change the International Settlements Policy ("ISP") and associated rules.

AT&T welcomes the Commission's review of its international settlements policies and supports the proposals to remove the ISP with foreign carriers that lack market power and where foreign markets are sufficiently competitive to prevent harm to the public interest. The Telecommunications Act requires the removal of regulations that are "no longer necessary in the public interest as the result of meaningful competition between providers." 47 U.S.C. Sect. 161(a)(2). As the Notice describes (¶ 15), the

1 *Notice of Proposed Rulemaking*, IB Docket No. 98-148, CC Docket No. 90-337 (rel. Aug. 6, 1998), FCC 98-190 ("Notice").

advent of competition in international telecommunications allows the modification of policies originally adopted to address the non-competitive nature of foreign markets.

The ISP should be retained with foreign dominant carriers, however, where sufficient competition does not yet exist in foreign markets to prevent harm to the public interest. The threshold tests should be whether U.S. carriers can settle traffic at best practices settlement rates or engage in viable international simple resale ("ISR").

Additionally, AT&T does not support the proposal to provide secrecy for under 25 percent flexibility arrangements while retaining public comment and review -- and a more onerous approval standard -- for the above 25 percent arrangements that disproportionately affect AT&T. The same notification and approval requirements should rather apply to all outbound flexibility arrangements.

The Commission should also maintain the existing ISR rules and prohibit grooming arrangements with the Bell Operating Companies, which would merely allow the anticompetitive leveraging of their U.S. bottlenecks.

I. THE COMMISSION SHOULD REQUIRE VIABLE ISR OPPORTUNITIES IN THE FOREIGN MARKET OR BEST PRACTICE RATES BEFORE REMOVING THE ISP FROM DOMINANT CARRIERS.

AT&T supports the proposed removal of the ISP for foreign non-dominant carriers, which is consistent with the allowance of special concessions with these carriers in the *Foreign Participation Order*, provided that the threshold question of whether a foreign carrier should be treated as non-dominant remains subject to public notice and comment.[2] Because the market power of existing and former monopolists continues unabated in most WTO markets, however, the Commission should tread cautiously in modifying the requirements of the ISP for U.S. carrier arrangements with foreign dominant carriers. In particular, it should not remove the ISP based merely on compliance with settlement rate benchmarks that remain far above cost.

While the Notice acknowledges that the removal of the ISP for foreign dominant carriers should take place only in competitive markets with low settlement rates, AT&T is concerned that the primary proposal set forth in the Notice (¶ 27) would make this judgment under flawed criteria that could leave U.S. carriers with no effective alternative means of terminating traffic in the foreign country. Specifically, the mere fact that the Commission may authorize U.S. carriers to engage in ISR to a foreign country because 50 percent of the traffic to that country is settled at benchmark settlement rates will not necessarily mean that the foreign country has a competitive market or that it will allow ISR arrangements. Yet, to remove the ISP where U.S. carriers cannot, in practice, engage in ISR would encourage dominant foreign carriers to engage in whipsaws and prevent settlement rates from being reduced below benchmarks to cost-based levels -- the long-standing Commission goal reaffirmed in the *International Settlement rate Order*.

The Commission should at least require the dominant carrier to have lowered settlement rates to "best practice" levels, or that U.S. carriers have the ability to

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2 AT&T concurs that the proposed modifications of the ISP rules should apply only to WTO Member countries. (Notice, ¶17.) Non-WTO Member countries generally present greater competitive concerns and, therefore, their carriers should not be given the greater freedoms that the removal of the ISP would provide.

terminate traffic in the foreign market through viable ISR arrangements under reasonable and nondiscriminatory terms and conditions for interconnection. These are the minimum safeguards necessary to allow the removal of the ISP from U.S. carrier arrangements with dominant foreign carriers without facilitating the very types of anticompetitive behavior that the ISP was originally designed to prevent.

1. The ISP Should Be Removed for Non-Dominant Foreign Carriers.

As the Notice describes (¶ 20), foreign carriers that lack market power raise few concerns regarding potential whipsawing because U.S. carriers can respond to such conduct by corresponding with another operator. U.S. carriers corresponding with a non-dominant carrier could readily switch traffic from the whipsawing non-dominant carrier to another non-dominant carrier in the foreign market or to the dominant carrier.

The Commission already recognizes the diminished ability of foreign carriers without market power to adversely affect competition in the U.S. market by allowing special concessions with these carriers[3] and by refraining from requiring U.S. carriers affiliated with these carriers from complying with dominant carrier regulation.[4] The removal of the ISP and the associated Section 43.51 Section 64.1001 filing requirements for U.S. carrier arrangements with these carriers would be consistent with this approach. AT&T supports this proposed step and shares the hopes expressed by the

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3 *Rules and Policies on Foreign Participation in the U.S. Telecommunications Market*, IB Docket No. 97-142, Report and Order and Order on Reconsideration, (rel. Nov. 26, 1997), FCC 97-398 ("*Foreign Participation Order*"), ¶ 156.

4 Until 1992, all "foreign-owned" U.S. carriers were regulated as dominant on all international routes. *See Regulation of International Common Carrier Services*, 7 FCC Rcd. 7331 (1992).

Notice (¶ 9) that the removal of the ISP will result in U.S. carriers obtaining lower settlement rates with foreign non-dominant carriers.[5]

However, the threshold question of whether a foreign carrier is entitled to non-dominant treatment should continue to be determined on the public record with full opportunity for comment by interested parties. Because of the much greater significance of a foreign carrier's status as dominant or non-dominant under the proposed removal of the ISP for non-dominant carriers, all U.S. carriers should continue to receive the notification of any change in that status that is provided by those existing procedures. Moreover, the question of whether an individual carrier has market power is not always "clear cut," as the Notice acknowledges (¶ 23), and will be even less so as the market shares of former incumbents fall toward the 50 percent level.

Therefore, all interested parties should continue to have the opportunity to address whether a particular carrier should be treated as non-dominant. Interested parties should also have the ability to request the further review of this question following any subsequent mergers, acquisitions or other changes in the foreign market.

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[5] Importantly, however, the de-regulation of U.S. carrier arrangements with foreign non-dominant carriers would provide no grounds for any relaxation of Commission enforcement of benchmark settlement rates with these carriers under the *International Settlement Rate Order*. U.S. carriers are required to negotiate benchmark rates with all foreign correspondents, both dominant and non-dominant, and the Commission has expressly rejected reliance "entirely on the market to reduce settlement rates on a timely basis to a more cost-based level." *International Settlement Rates*, 12 FCC Rcd. 19806, 19824 (1997) ("*International Settlement Rate Order*").

2. The Prevention of Whipsawing By Foreign Dominant Carriers Will Remain A Significant Concern After The Achievement of Benchmark Rates.

As the Commission found in the *International Settlement Rate Order* last year, "effective competitive market conditions exist in only a few countries. Monopoly conditions prevail in most."[6] Even after the entry into force of the WTO Agreement, the dominant operators in most WTO Member countries are, and will remain, monopolists. A number of WTO Member countries have opened their markets, and a few have also reduced settlement rates to levels approximating cost, but competitive conditions in most WTO Member countries differ little from those that originally required the adoption of the ISP.[7]

The Commission has long recognized the potential abuse of foreign market power to extract concessions from U.S. carriers that harm the interests of U.S. consumers. It stated sixty years ago in *Mackay Radio*:

> "To expect the [foreign] administration to play the competing [U.S.] companies against each other is simply to expect that the administration will be headed by

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6 *Id.*, at 19824.

7 As the Notice acknowledges (¶ 15), only 28 countries (of the more than 130 WTO Member countries) committed to competition on January 1, 1998 under the WTO Agreement. The Commission's August 1,1998 report *IMTS Accounting Rates of the United States, 1985-1998*, lists only 18 WTO Member countries as having more than one carrier with accounting rate arrangements with U.S. carriers, and provides further evidence of the slow pace at which competition is being established in these countries. Only 52 WTO Member countries made commitments to grant market access for international services either now or in the future, including 22 countries that made commitments that will not be effective until the year 2000 or, in many instances, until much later. *See Rules and Policies on Foreign Participation in the U.S. Telecommunications Market*, IB Docket No. 97-142, Order and Notice of Proposed Rulemaking, (rel. June 4, 1997), FCC 97-142, ¶ 62. Almost half of all WTO Member countries made no market-opening commitments at all.

> good businessmen, loyal to their national interests. To rely upon companies which are bitter competitors not to make concessions to the administration which controls all outgoing radiotelegraph traffic is to provide an exceedingly tenuous basis upon which to rest public interest."[8]

The Commission specifically recognized the continued market power of dominant foreign carriers following the entry into force of the WTO Agreement by establishing a comprehensive competitive safeguards framework to govern the U.S. international services market, including revised dominant carrier regulations.[9] The Commission found that both monopolists and dominant carriers facing some competition could "engage in price and non-price discrimination against unaffiliated U.S. carriers."[10] Notably, as the Notice cautions (*id.*), "a large number of countries still have dominant

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8 *Mackay Radio and Telegraph Co. Inc.*, 2 F.C.C. 2d 592, 599 (1936), *aff'd Mackay Radio and telegraph Co. v. FCC*, 97 F.2d 641 (D.C. Cir. 1938). The Commission reaffirmed this view in extending the uniform settlements policy from international record services to include international voice services when this market became competitive in the mid-1980's:

> "Absent the USP, operating agreements would more directly reflect the advantageous marketing positions of the PTTs. The result would be a loss of revenues to the U.S. industry, and ultimately a loss to the U.S. public. . . . To allow whipsawing of the U.S. carriers by the PTTs would be to allow those administrations to claim for themselves and their customers, to the detriment of the U.S. public, the benefits of competition among the U.S. carriers."

Implementation and Scope of the Uniform Settlements Policy for Parallel Routes, 51 Fed. Reg. 4736 (1986) (Report and Order) (¶ 24), *modified in part on recon.*, 2 FCC Rcd. 1118 (1987), *further recon.*, 3 FCC Rcd. 1614(1988).

9 *See generally, Foreign Participation Order*, Section V. These new safeguards resulted from the Commission's "fundamental premise that market power on the foreign end of a U.S. international route – if unrestrained – could be leveraged into the U.S. market to the detriment of competition and U.S. consumers." *Id.*, ¶ 149.

10 *Id.*, ¶ 227.

operators which charge U.S. carriers settlement rates that are many times the cost of terminating international traffic."[11]

Although the Notice (¶ 25) describes its proposals as lifting the ISP for all carrier arrangements only "in liberalized markets with low settlement rates," it goes on to propose removing this safeguard under a standard that offers neither adequate liberalization nor sufficiently low settlement rates to avoid potential harm to U.S. consumers and carriers. The primary proposal set forth in the Notice (¶ 27) is to remove the ISP "on routes where the Commission has already authorized ISR." Contrary to the arguments put forward in support of this proposal, however, there is no "significantly reduced threat" of competitive injury from removal of the ISP in such circumstances when, as the Notice describes (*id.*), ISR may be authorized by the Commission merely "where 50 percent of the traffic on the route is settled at or below benchmark rates." The Notice thus effectively proposes to remove the ISP for dominant foreign carriers that provide benchmark rates.

The Notice (¶ 27) acknowledges that "whipsawing by a foreign carrier that has already agreed to settle traffic at or below benchmarks" would adversely affect U.S. carriers and consumers.[12] A significant objective of the foreign dominant carrier engaging

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11 *See also, International Settlement Rate Order*, 12 FCC Rcd. at 19820 ("inflated settlement rates 'in effect impose [] monopoly pricing on customers located in open markets' such as the United States").

12 As the Notice observes (¶ 27, n.36), this behavior could take a variety of forms in addition to playing U.S. carriers off against each other to coerce acceptance of arrangements that raise settlement rates or outpayments. In addition to refusing to lower settlement rates, the dominant carrier would likely seek to raise U.S.

(Footnote continued on next page)

such behavior would be to prevent reductions in settlement rates below benchmark levels, which, particularly in middle and lower income countries, are more than twice the Commission's most conservative estimate of costs ($0.09). This would frustrate the achievement of "settlement rates that reflect incremental costs" to which the Commission has emphasized that it is "still committed ultimately to achieving" beyond benchmark rates.[13] Thus, if the Commission allowed the removal of the ISP for all carriers in WTO countries providing benchmark rates, it would reduce the prospects of achieving lower, cost-based settlement rates below the benchmarks with the monopoly carriers that continue to control most of these markets and it would lengthen the period required to achieve these rates in other markets.

Because the Notice fails to take full account of the adverse impact of such whipsaw behavior on the prospects of lowering rates below benchmarks following the removal of the ISP, it mistakenly contends that any such effects would be "outweighed by the pro-competitive effect that removing the ISP will have on the U.S. international services market." However, the removal of the ISP from arrangements with dominant foreign carriers in markets where U.S. carriers have no alternative means to terminate

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outpayments (and U.S. carrier costs) through lower termination costs in the U.S., such as by "requiring U.S. carriers to agree to a non-50/50 split in the accounting rate." (Notice, ¶ 27, n.36) Moreover, there are myriad ways in which a foreign carriers may lower the inbound traffic termination costs of favored U.S. correspondents and raise those of favored correspondents, such as by sending the favored carrier higher proportions of non-peak hour calls, more valuable operator-handled calls, or calls terminating in the U.S. over short distances.

13 *International Settlement Rate Order*, 12 FCC Rcd. at 19827.

traffic is unlikely to encourage agreements to lower rates with U.S. carriers. Unless U.S. carriers can bypass the foreign bottleneck and terminate traffic in the foreign market under viable ISR arrangements, or unless the foreign dominant carrier has already lowered settlement rates to best practice levels, the removal of the non-discrimination requirements of the ISP is much more likely to lead to accommodation and whipsaws than to more aggressive negotiating by U.S. carriers.[14]

Where U.S. carriers can settle traffic at best practices rates, any potential adverse effect on the public interest from a whipsaw is greatly diminished. Best practice settlement rates provide a reasonable surrogate for the cost-based rates that remove unreasonable profits from the foreign carrier's control of termination facilities. Alternatively, the ability to obtain viable ISR arrangements in the foreign market provides U.S. carriers with another means of terminating international traffic that bypasses the settlements process, impedes any attempted whipsaw and continues to exert competitive pressure to lower settlement rates below benchmark levels. The presence of either or both of these conditions in the foreign market would greatly diminish the public interest harm that may otherwise result from the removal of the ISP. These are accordingly the

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[14] By establishing enforceable benchmark rates last year, the Commission recognized that negotiations by U.S. carriers, by themselves, are insufficient to obtain lower settlement rates with dominant foreign carriers. AT&T, which has negotiated long and hard with foreign carriers for lower settlement rates, fully agrees with this judgment. Commission policies, in the form of the ISP and now the benchmark rates established by the *International Settlement Rate Order*, provide critical reinforcement for the efforts of U.S. carriers.

minimum criteria that should be required before the ISP is removed from U.S. carrier arrangements with foreign dominant carriers.[15]

3. Commission Authorization of ISR Would Not Support Removal of the ISP <u>Without the Existence of Viable ISR Opportunities in the Foreign Market.</u>

The viable ISR opportunities that should be required in foreign markets before the ISP is removed should require much more than the mere authorization of these services by the Commission. Although the Notice (¶ 26, n 24) is correct in highlighting the ability to bypass the foreign international carrier that ISR provides, it overlooks a critical point regarding the nature of prior Commission ISR authorizations. Specifically, where ISR has been authorized because 50 percent or more of U.S. traffic is settled at or below benchmark rates (such as Denmark, the Netherlands, Germany, France and Japan), there is no <u>necessary</u> relationship to the fact that these countries have also allowed "U.S. carriers [] the ability to interconnect directly with the local operator, rather than relying on a traditional correspondent relationship with the foreign international carrier." (*Id.*)

In short, it is quite possible under this standard that the Commission could authorize U.S. carriers to engage in ISR to a country that prohibits these services -- particularly when benchmark rates are obtained with non-liberalized countries. This situation would have serious adverse consequences for U.S. consumers and carriers if the

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15 Maintenance of the ISP with foreign dominant carriers, except where U.S. carriers have the ability to terminate traffic at best practices settlement rates or where they can clearly engage in ISR, is also required to protect U.S. carriers against collusive whipsaw arrangements in foreign markets following the removal of the ISP for arrangements with non-dominant carriers. Otherwise, U.S. carriers would have no alternative means of terminating traffic if such a carrier then sought to exert a whipsaw in collusion with other carriers.

Commission's ISR authorization also triggered the removal of the ISP, which is a significantly greater step.[16]

The potential pitfalls of such an approach are illustrated by Mexico, which resolutely refuses to honor its WTO commitment to allow ISR services.[17] Yet, under the proposal described by the Notice, the ISP will be removed for all U.S. carrier arrangements with Mexico once U.S. carriers obtain the $0.19 benchmark rate with Mexico, as the Commission requires by January 1, 2000. Enforcement of Mexico's WTO obligation to allow ISR could take much longer under WTO dispute procedures, particularly as Mexico would be allowed up to 15 months to implement changes in its laws and regulations after an adverse WTO decision, during which there is no right to retaliation or other compensation.[18]

Similar problems would occur with other countries not authorizing ISR, however proper or improper may be their failure to do so. For example, Israel's WTO

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[16] Although it is already possible that the Commission could authorize ISR to a market that does not allow these services, this situation would not adversely affect consumers because traffic on the route would simply remain subject to the ISP. If the foreign carrier then attempted to use the Commission's authorization to terminate its U.S.-bound traffic at lower rates (*i.e.*, to engage in one-way bypass), it would potentially trigger the market distortion thresholds established by the *Foreign Participation Order*. The removal of the ISP, however, would make this ISR market distortion safeguard unworkable, as demonstrated below in Section III.

[17] *See* World Trade Organization, Mexico, Schedule of Specific Commitments, Supplement 2, GATS/SC/56/Suppl.2, Apr. 11, 1997.

[18] *See* WTO Understanding on Rules and Procedures Governing the Settlement of Disputes, Arts. 4, 6, 20, 21, House Document 103-316, Vol. 1, 103d Cong., 2d Sess. (Sept. 27, 1994), 1654.

commitments state that "International simple resale is not permitted,"[19] but the Commission would nonetheless remove the ISP once U.S. carriers obtain benchmark rates on this route, as they are required to do by January 1, 1999.

The Commission must also look beyond whether "the foreign market permits U.S. carriers to provide service via ISR," which is the alternative ISR standard proposed by the Notice (¶ 29). The fact that U.S. carriers may have the legal right to provide ISR services in a foreign country would provide no practical assistance in countering whipsaw behavior by the foreign dominant carrier following the removal of the ISP if traffic could not be terminated through ISR under reasonable terms and conditions.

For example, the International Bureau found only last month that Chile's theoretically "open" market for ISR imposes discriminatory access charges on international calls terminating in Chile.[20] Unreasonably high interconnection charges, whether imposed on a one-way inbound basis like Chile, or on all international calls, would greatly limit the utility of ISR to U.S. carriers.

A further example of how the alternative ISR standard proposed by the Notice could be abused is provided by the ISR policy initially proposed last year by Japan, which would have subjected this traffic to settlements payments and proportionate return,

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[19] *See* World Trade Organization, Israel, Schedule of Specific Commitments, Supplement 1, GATS/SC/44/Suppl.1, Apr. 11, 1997.

[20] *Americatel Corp., et al.*, Order and Authorization (rel. Aug. 7, 1998), ¶ 4 (finding that Chile does not meet equivalency requirements for this reason).

thus eliminating all the benefits of ISR.[21] Although Japan did not subsequently implement these proposals, they vividly demonstrate why an ISR standard that failed to look beyond the existence of the bare legal right to terminate ISR services in the foreign market before removing the ISP for dominant carriers would not ensure the existence of meaningful alternative termination opportunities for U.S. carriers.

At a minimum, the Commission should require the presence of the *de jure* and interconnection prongs of the equivalency test in making this judgment. In addition to the legal ability to terminate switched services over international private lines in the foreign market, this would ensure the existence of "reasonable and nondiscriminatory charges, terms and conditions" for the interconnection of ISR services.[22] As the Commission has repeatedly found in its decisions applying the equivalency test, the availability of reasonable and nondiscriminatory terms and conditions for interconnection in the foreign market is absolutely necessary before U.S. carriers can engage in ISR on a viable basis.[23] This bedrock requirement should be retained as a threshold condition here to ensure the existence of meaningful ISR origination and termination opportunities on the route before U.S. carriers lose the protections of the ISP for their arrangements with

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21 Proposed Policy on the Liberalization of Usage of International Private Leased Circuit with Interconnection to the Public Switched Network, Ministry of Posts and Telecommunications, Japan, June 8, 1997.

22 *See, e.g., KPN US Inc.*, File No. ITC-97-382, Order, Authorization and certificate (rel. Jan. 30, 1998), ¶ 9; *Telecom New Zealand Limited*, 13 FCC Rcd. 7858, 7859 (1997).

23 *See, e.g., Cable & Wireless Inc.*, 12 FCC Rcd. 21692 (1997) (Australia); *ACC Global Corp.*, 9 FCC Rcd. 6240 (1994) (UK).

foreign dominant carriers.[24]

4. The Scope of the No Special Concessions Rule Should Be Clearly Defined Following the Removal of the ISP.

AT&T supports the retention of the No Special Concessions rule for operating agreements, interconnection of international facilities, private line provisioning and maintenance and quality of service following any removal of the ISP for arrangements with dominant carriers, as proposed by the Notice (¶¶ 40-41). However, any application of the No Special Concessions rule to the areas presently covered by the ISP would merely reintroduce the same requirements under a different label.

Thus, just as flexibility arrangements are an established exception to the No Special Concessions rule, the removal of the ISP should preclude the application of the No Special Concessions rule to "the settlement of international traffic and allocation of return traffic," (Notice, ¶ 40), unless the Commission is to take away with one hand what it gives with the other. For the same reason, the Notice properly suggests (¶ 41) that the No Special Concessions rule does not apply "to the terms and conditions under which traffic is settled, including allocation of return traffic" on ISR routes. To avoid introducing complexity that would impede rather than promote competition, the Commission should address potential anticompetitive concerns by retaining the ISP for arrangements with

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24 There would be no merit to any claim that the use of such a standard would be contrary to the WTO obligations of the U.S. USTR emphasized in its Comments filed in the *Foreign Participation* proceeding that the Commission may legitimately take account of foreign market conditions, including "problems with interconnection for the provision of international services" in evaluating competitive effects. Comments of the U.S. Trade Representative, IB Docket No. 97-142, filed Jul. 9, 1997, at 3.

foreign dominant carriers where threshold requirements for viable ISR or best practice rates are not fulfilled.[25]

II. THE PROPOSED FLEXIBILITY MODIFICATIONS WOULD ADVERSELY AFFECT AT&T AND ENCOURAGE WHIPSAWS TO PREVENT THE ENFORCEMENT OF BENCHMARK RATES.

AT&T opposes the proposal (Notice, ¶ 33) to modify the Commission's flexibility policy by allowing carriers to seek authorization for below 25 percent alternative settlement arrangements without disclosing the terms and conditions of the agreement or identifying the foreign correspondent. The proposal would unfairly benefit smaller U.S. carriers and encourage whipsaws to raise U.S. settlement outpayments and to prevent U.S. carriers from seeking enforcement of the Commission's benchmark settlement rates.

The proposal would adversely impact AT&T, which is already disadvantaged on these routes because flexibility arrangements affecting more than 25 percent of the inbound or outbound traffic (a) entail more onerous filing arrangements, and (b) must not contain "unreasonably discriminatory" terms and conditions. AT&T lacks market power, as the Commission found in 1996, but is subject to these restrictions -- and the resulting unit cost disadvantage -- because of its market shares above 25 percent on virtually all routes. In contrast, some U.S. carriers are free of these restrictions on all

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[25] AT&T supports the proposal (Notice, ¶ 48) to provide public notice of accounting rate filings by placing this information on the Commission's web site, which would provide this information in a more efficient, less burdensome fashion than by continuing to require service on other carriers or by issuing a public notice. However, AT&T supports the retention of accounting rate notification procedures. (¶ 47.) Although these procedures have not been widely used in the past, partly because of the retroactive nature of many accounting rate changes, there appears to be no compelling reason to preclude their potential use by more carriers in the future.

of their traffic.

The Notice would increase this adverse impact by removing filing obligations only for flexibility arrangements under 25 percent -- ensuring that AT&T will be required to disclose the terms and conditions of its arrangements with dominant carriers in multi-carrier WTO markets on more than half its traffic, while most other U.S. carriers are allowed to make secret arrangements for all their traffic to these markets.

As stated by Dr. William Lehr in the attached affidavit (p. 4), "[a]pplying asymmetric regulatory constraints to a subset of carriers that do not possess market power in anticompetitive. It distorts competition among the remaining participants without market power and strengthens the position of those that actually possess such power." He concludes that the likely result is diminished competition, higher consumer prices and reduced pressure to lower settlement rates to cost-based levels.[26] Lehr Aff. at 8.

Whipsaw strategies by dominant foreign carriers are also encouraged if some of the U.S. carriers are able to enter into secret arrangements with dominant foreign carriers in multi-carrier WTO markets for all their traffic. Foreign carriers with high settlement rates and no effective termination alternatives in their markets will engage in this misconduct to keep U.S.-outbound settlement rates high and to settle U.S.-inbound traffic with the lowest bidder. A key objective will be to prevent U.S. carriers from seeking enforcement of the benchmark rates.

AT&T should be subject to the same disclosure or non-disclosure requirements as its competitors. The 25 percent threshold should be removed, for the

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[26] The affidavit by Dr. William Lehr is Attachment 1 hereto.

reasons originally set forth in its March 1997 Petition for Reconsideration of the *Flexibility Order*, and the further unfair handicap on AT&T proposed by PBCom and NYNEX should be rejected.

The Commission should also review the need for flexibility arrangements at all if it modifies the ISP rules for all non-dominant carriers and for all carriers in truly competitive markets. The removal of the ISP in these circumstances would largely achieve the flexibility originally sought in adopting the original *Flexibility Order* in 1996. The major beneficiaries of further departures from the ISP are likely to be foreign dominant carriers with high settlement rates rather than U.S. consumers.

1. AT&T Would Be Unfairly Disadvantaged By Removal of the Under-25 Percent Filing Requirement.

The Commission now allows flexible arrangements in all WTO markets, provided they have "more than one" facilities-based carrier with "the ability to terminate traffic and serve existing customers in the foreign market."[27] Accordingly, the proposal to remove existing filing requirements for under 25 percent flexibility arrangements would, in effect, remove Commission regulation entirely from some U.S. carrier arrangements with dominant non-affiliated carriers in WTO markets with more than one carrier.[28]

The removal of the below-25 per cent filing requirement would adversely affect AT&T, by virtue of its market shares of approximately twice this level on virtually

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27 *Foreign Participation Order*, ¶ 307.

28 As the Notice observes (¶ 39), the implementation of the other ISP modification proposals would limit the effect of Commission's flexibility policies to arrangements

(Footnote continued on next page)

all routes to multi-carrier WTO markets. AT&T already faces a significant cost disadvantage because of its inability to negotiate flexibility arrangements for all its traffic on the same terms as its U.S. competitors. If most other U.S. carriers are also allowed secret arrangements for all their traffic on these routes -- as would be the effect of the proposal [29]-- AT&T would be harmed to an even greater degree.

Unlike the carriers with secret arrangements, AT&T would be (a) required to reveal the settlement rates paid on more than half its traffic on virtually all these routes, (b) prevented from changing the settlement rates paid on more than half its traffic until expiration of the time periods required under the Commission's accounting rate modification or public notice procedures, and (c) potentially subject to further delay in implementation of those rate changes as the result of challenges under those procedures by other U.S. carriers.

As demonstrated by Dr. Lehr, these restrictions would "reduce[] [AT&T's] ability to negotiate efficient settlement agreements. A foreign carrier would find it more advantageous to negotiate with competitors who do not face the same public disclosure and non-discrimination obligations imposed on AT&T." Lehr. Aff. at 7. Foreign carriers will also have "an increased incentive to negotiate a higher settlement rate on the majority

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with foreign carriers with market power and with settlement rates above the benchmark level.

29 Most other U.S. carriers have market shares under 25 percent on all routes to multi-carrier WTO markets. WorldCom/MCI would also exceed this level on these routes, but for smaller proportions of traffic generally than AT&T.

of AT&T's traffic that is subject to disclosure as a signal to other potential negotiating partners." *Id.*

These consequences would "result in higher unit costs" and increase the significant unit cost disadvantages that are already unique to AT&T because the 25 percent threshold prevents it from negotiating unrestricted flexibility arrangements for the same proportions of its traffic as its competitors.[30] *Id.* at 5-6. Because of the loss of inbound traffic that would inevitably result from the ability of foreign carriers to give that traffic secretly to the lowest U.S. bidder, AT&T would also be left with a decreased pool of inbound minutes to off-set its higher rates on outbound minutes. This would also harm competition. Where restrictions raise costs for larger firms and "favor potentially less efficient entrants," the larger carriers' "scale economies will not be fully reflected in prices." Lehr. Aff. at 7.

The Commission reached similar conclusions in removing dominant carrier regulation from AT&T's international services in 1996 because of AT&T's lack of market power. It found that "the longer tariff-filing notice periods applicable to AT&T as a dominant carrier" could have "anticompetitive consequences once AT&T is no longer dominant" because "restricting the competitiveness of the largest carrier only reduces

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[30] They require that arrangements affecting 25 percent or above of the traffic on a route not be "unreasonably discriminatory," but place no such restrictions on below-25 percent arrangements. *See Regulation of International Accounting Rates*, 11 FCC Rcd. 20063 (1996) ("*Flexibility Order*").

competitive performance in the market."[31] As shown by Dr. Lehr, to continue transparency and notice periods for the major portion of AT&T's settlement costs on these routes, while exempting most other U.S. carriers from similar requirements, would similarly "slow[] rivalry" in the international market.[32] All U.S. carriers should rather be subject to the same disclosure or non-disclosure requirements.

2. Different Treatment of U.S. Carrier Arrangements Would Encourage Whipsawing.

Dominant foreign carriers seeking to preserve and increase their settlement rate profits would also benefit from this different treatment of U.S. carriers. As demonstrated above, whipsawing remains a significant enduring concern, not only in connection with "foreign carriers with monopoly power," as stated by the Notice (¶ 18), but also by foreign dominant carriers facing some competition, unless the dominant carrier has already lowered settlement rates to "best practice" levels, or unless U.S. carriers can avoid the settlements process altogether by terminating their traffic through viable ISR arrangements in the foreign market.

Additionally, foreign dominant carriers in countries that have not lowered their settlement rates to the benchmarks required by the *International Settlement Rate Order* now have further incentives to leverage U.S. carriers through whipsaw behavior. Because U.S. carrier complaints are required to initiate the benchmark enforcement procedures established by the *International Settlement Rate Order*, foreign dominant

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[31] *Motion of AT&T Corp. to be Declared Non-Dominant for International Service*, 11 FCC Rcd. 17963, 17966 ("*AT&T International Non-Dominance Order*") (1996).

carriers in non-compliant countries may seek to prevent such complaints by punishing, dissuading, or rewarding U.S. carriers accordingly.

The proposal set forth in the Notice would encourage such misbehavior by giving added flexibility to arrangements with dominant carriers in all multi-carrier WTO markets. Unlike the proposal elsewhere in the Notice for the removal of the ISP with dominant carriers, there would be no threshold requirement even for benchmark settlement rates. Indeed, a number of the multi-carrier WTO markets with which such arrangements would be allowed -- such as the Dominican Republic, El Salvador, Indonesia, Jamaica, Malaysia, Mexico and the Philippines -- do not allow ISR, have settlement rates many times higher than cost, and will not be subject to benchmark rates until 2000 or 2001.[33]

The dominant carriers in these markets would inevitably seek to exploit the competitive U.S. market to maintain or raise the cost of terminating U.S.-outbound traffic, lower the amounts they pay U.S. carriers for terminating U.S.-inbound traffic, and thereby raise U.S. outpayments. For example, they could increase their settlement profits (and U.S. outpayments) simply by terminating U.S.-inbound traffic in separate below-25

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32 *Id.*

33 Flexible arrangements with dominant carriers in effectively competitive multi-carrier markets with settlement rates at the best practices level, such as Sweden and the UK, do not give rise to potential concern. The ability of U.S. carriers to terminate calls in those countries with other carriers at rates approximating cost, either under traditional correspondency arrangements or through ISR, ensures that flexibility will not raise U.S. settlement rates or outpayments.

percent arrangements with the lowest bidding U.S. carriers. If the dominant foreign carriers in these markets could enter into secret arrangements with some U.S. carriers, while AT&T remained subject to filing requirements for the majority of its traffic on those routes, the bargaining position of the dominant foreign carriers would be further strengthened, as demonstrated by Dr. Lehr. As a result, the benefits of flexible arrangements are more likely to accrue to the dominant foreign carriers than to U.S. consumers.

To demonstrate the potential harm to the U.S. public interest from this proposal, the Commission need look no further than Mexico, a multi-carrier WTO market, where the latest $0.395 settlement rate was more than five times higher than cost, and U.S. carriers' $875 million outpayments in 1996 were almost three times larger than on any other route. Although the Mexican market was nominally opened to competition in 1997, the Mexican government has sought to protect the settlement profits of the dominant incumbent carrier, Telmex, by, among other things, prohibiting its competitors from negotiating settlement rates with U.S. carriers[34] and by failing to honor Mexico's WTO obligation to allow ISR services. Because of the regulatory barriers protecting Telmex, Mexico's status as a multi-carrier WTO market would provide little or no protection against whipsaw behavior by Telmex. Other WTO Member countries, in Latin

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[34] *See* Rules to Render the International Long-Distance Service That Must be Applied by the Concession Holders of Public Telecommunications Networks Authorized to Render this Service ("International Long-Distance Service Rules"), Ministry of Communications and Transport, Mexico, Dec. 4, 1996), Rule 13.

America and elsewhere, have implemented or are considering similar regulations to protect their incumbent carriers from competition.

The Commission's *Flexibility Order* recognized that the potential adverse effects on the public interest of below-25 percent alternative settlement arrangements required potential Commission review of all such arrangements "regardless of whether they trigger our safeguards, to ensure that they meet our policy objectives and will not have a significant adverse impact on U.S. net settlement payments and resulting traffic volumes."[35] Although the Commission expressly retained this right of review in the *Foreign Participation Order*,[36] no such review can occur if carriers are under no obligation to file a summary of the terms and conditions of below-25 percent arrangement and to identify the foreign correspondent, as proposed by the Notice. The Notice fails to recognize this inconsistency with the safeguards established by the *Foreign Participation Order* and identifies no subsequent change in circumstances warranting the removal of this Commission review after such a brief interval.

The Commission should also review whether the continuation of its flexibility policies is necessary at all if the ISP is removed for all foreign non-dominant carriers and in all markets that are sufficiently competitive. Notably, the adoption of this approach would achieve the flexibility originally sought by the 1996 *Flexibility Order*. That order allowed flexibility with foreign carriers in markets satisfying the ECO test and in other markets where "deviation from the ISP will promote market-oriented pricing and

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35 *Flexibility Order*, 11 FCC Rcd. at 20087 (1996).

competition, while precluding abuse of market power."[37] It specifically cited arrangements with foreign non-dominant carriers and in markets "where a foreign regulator guarantees cost-based interconnection for international traffic" as providing examples of these latter circumstances.[38]

The removal of the ISP for arrangements with non-dominant carriers in all markets, and for all carriers in markets satisfying the threshold tests proposed by AT&T in Section I above (*i.e.*, where settlement rates are at best practice levels or U.S. carriers can engage in ISR on a viable basis), would allow complete flexibility in all the market circumstances specified by the *Flexibility Order*. For the reasons described above, allowing greater flexibility, particularly if there is no disclosure for under-25 percent arrangements, merely encourages the "abuse of market power by a foreign carrier to the detriment of U.S. carriers" anticipated by the *Flexibility Order*.

3. The 25 Percent Threshold For Alternative Settlement Arrangements Should Be Removed.

AT&T welcomes the request (¶ 37) for comment on the flexibility safeguards, and (¶ 50) for further comment on the issues raised by the petitions for reconsideration of the *Flexibility Order*, and again requests the removal of the unjustified and discriminatory criteria and filing requirements imposed on 25 percent or above

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36 *Foreign Participation Order*, ¶ 308 ("We retain this right here.")

37 *Flexibility Order*, 11 FCC Rcd. at 20080.

38 *Id.*

alternative settlement arrangements. AT&T demonstrated in its March 1997 Petition for Reconsideration of the *Flexibility Order* and April 1997 Reply Comments that the 25 percent threshold is entirely arbitrary, with not one scintilla of evidentiary support in the record, and contrary to the finding elsewhere in the *Flexibility Order* that alternative settlement arrangements should not be limited to certain carriers on the basis of "size-based criteria."[39]

Efforts by the respondents to AT&T's original petition to justify the 25 percent threshold were little more than arguments that a 25 percent market share equates to market power on a route. Their arguments were in direct contradiction of the Commission's prior findings in the 1996 *AT&T International Non-Dominance Order* that AT&T lacks market power and that "market shares, by themselves, are not the sole determining factor of whether a firm possesses market power."[40] Indeed, the permanent competitive disadvantage imposed on AT&T by the 25 percent threshold is at variance with the Commission's recognition in the 1996 *AT&T International Non-Dominance Order* that dominant regulation "may hinder competition . . . if applied to a carrier that no longer has market power."

Because smaller U.S. carriers may use flexible arrangements to lower settlement rates for all of their traffic on a route, an opportunity denied to AT&T, the

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39 *Id.* at 20076, 20080. *See also,* Lehr Aff. at 3 ("the 25% rules asymmetrically singles out carriers such as AT&T that happen to have the largest share of traffic along a particular route"); *id.* at 6 (25% is an "arbitrary" choice).

25 percent threshold allows smaller U.S. carriers to obtain a lower overall per minute settlement rate than AT&T, and thus to price at lower levels. As shown above, the new proposal set forth in the Notice to draw a veil of secrecy over below-25 percent arrangements would further tilt the competitive playing field against AT&T.[41]

There is also no justification for the proposals made in the petitions by PBCom and NYNEX to further increase the disadvantages imposed on AT&T's flexible arrangements. These proposals would establish a presumption that exclusive arrangements are unreasonably discriminatory, requiring that all 25 percent and above flexible arrangements be offered on an identical basis to all U.S. carriers, and imposing a continuing obligation to justify such arrangements. Their proposal would impose obligations far beyond the requirements of the ISP, which has never required absolute uniformity or made U.S. carriers responsible for the availability of operating agreements to all other U.S. carriers.[42] Moreover, the fact that an exclusive arrangement may not be

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40 *AT&T International Non-Dominance Order*, 11 FCC Rcd. at 17976. *See also, Foreign Participation Order*, ¶ 161 ("We recognize that market share is but one factor in a traditional market power analysis.").

41 As stated in its original petition, AT&T does not seek the removal of the 25 percent threshold on inbound traffic for as long as settlement rates are above cost-based levels in order to limit the potential diversion of inbound traffic through these arrangements.

42 *See Implementation and scope of the International Settlements Policy for Parallel International Communications Routes*, 2 FCC Rcd. 1118 (1987) ("[U]niformity is not an end in itself. Our objectives are to ensure that American consumers receive the benefits that result from the provision on international services on a competitive basis. Departures from uniformity are permissible if the particular departure does not conflict with these objectives.")

available to all carriers does not mean that it is unreasonably discriminatory. For example, an exclusive arrangement affecting more than 25 percent of the traffic on a route would not be unreasonably discriminatory if it was entered into with one of many competing carriers in a market subject to effective competition.

There is also no justification for retaining the filing requirements for alternative settlement rate arrangements with affiliated carriers and joint venture partners that lack market power. As the Notice concludes (¶ 34), there is no likelihood that such an arrangement would have anticompetitive effects. The Commission already allows special concessions with such carriers and does not impose dominant carrier regulation on such routes. The Notice proposes to remove the ISP for traffic terminated with non-dominant carriers, thus allowing flexible arrangements with all non-dominant non-affiliated carriers, and there is no reason for any different treatment of non-dominant affiliates and joint venture partners.

III. THE COMMISSION SHOULD MAINTAIN ITS EXISTING ISR RULES.

As the Notice emphasizes (¶ 37), the prevention of one-way bypass has been a long-standing Commission concern. ISR authorizations leading to the inbound bypass of settlements "could increase the net settlements payments of U.S. carriers, and ultimately could lead to increased calling prices for U.S. consumers," which would be the exact opposite of the intended result of authorizing ISR services "as a mechanism for putting greater pressure on settlement rates." (*See, id.*) The modifications to the ISR rules suggested by the Notice, however, fail to meet the acknowledged requirement (¶ 38) of being "consistent with [the Commission's] commitment to prevent one-way bypass."

They would do little to lower settlement rates, while extending these services to routes raising serious risks that bypass would occur.

The Commission only recently modified its ISR rules in the *Foreign Participation Order* to allow these services where 50 percent of traffic is settled at benchmark rates. Although it also established quarterly reporting requirements and a market distortion presumption to address bypass concerns, it is not yet possible to evaluate the adequacy of these new safeguards. They will also be rendered largely ineffective by the removal of the traffic distinctions on which they depend with the removal of the ISP.

1. The Suggested Modifications Would Raise Bypass Risks While Failing to Encourage Lower Settlement Rates.

The Notice suggests (¶ 38) that ISR should be authorized for "a limited amount of traffic" on routes not otherwise qualifying for ISR, and that the Commission should "lift [its] ISP requirement at some future point when international markets have become sufficiently competitive overall, *e.g.*, when 50 percent of routes have been approved for ISR." The adoption of either change to the Commission's recently modified ISR rules would simply encourage one-way bypass by the very countries that have the greatest incentives to engage in this conduct.

The Commission now approves WTO routes for ISR either when 50 percent of the traffic on the route is terminated at benchmark rates or when equivalency requirements are fulfilled. By definition, WTO countries meeting neither of these requirements are those with high settlement rates and that prohibit U.S. carriers from engaging in ISR on a viable basis. Most are dominated by existing or former monopolists with greater incentives to engage in one-way bypass than carriers complying with benchmark rates because of the greater profits that may be obtained by bypassing higher settlement rates.[43]

Opening ISR to all countries at some future point or introducing an "ISR quota" on all routes would do little or nothing to lower settlement rates, as most of the new countries to which ISR would be authorized do not allow U.S.-outbound calls to be terminated in this way. However, it would undoubtedly encourage one-way in-bound bypass by the foreign carriers with the greatest incentives to engage in this activity. Further, the adoption of the proposals to reduce the scope of the ISP and allow secret under 25 percent flexibility arrangements set forth elsewhere in the Notice would limit the relevance of the ISR rules even further. Foreign monopoly carriers with above-benchmark rates would then be the only possible beneficiaries of these policies.[44]

Additionally, a quantitative restriction on the amount of ISR traffic on any route would merely address the size of the potential inbound bypass harm to U.S. consumers and carriers. It would do nothing to reduce the likelihood or change the nature

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[43] *See International Settlement Rate Order*, 12 FCC Rcd. at 19918 (finding that "the requirement that settlement rates be at or below the relevant benchmark substantially reduces the financial incentives to engage in one-way bypass").

[44] This would be the effect if the Commission adopted the proposals to (a) remove the ISP from all arrangements with foreign non-dominant carriers, (b) remove the ISP from arrangements with all carriers in WTO markets meeting the settlement rate benchmarks, and (c) allow secret under-25 percent flexibility arrangements in multi-carrier WTO markets. Moreover, if this proposal was adopted, any removal of the ISP on all routes on which ISR was allowed by the Commission would automatically remove the ISP for all WTO countries, and further increase the widespread anticompetitive abuse that would inevitably result from this approach.

of that harm. It is also unclear how any "ISR quota" on each route would be distributed among carriers on an equitable basis and consistent with the antitrust laws without extensive regulation by the Commission.

2. **No Reliance Should Be Placed On New And Untested Reporting Safeguards.**

It is also highly premature to reach any conclusion regarding the effectiveness of the Commission's reporting safeguards for ISR and whether they would prevent one-way bypass "in lieu of" other existing safeguards, as the Notice requests (¶ 38). Those safeguards employ a presumption that market distortion exists if the ratio of inbound/outbound traffic increases by ten percent or more over two successive reporting periods. They were adopted when the Commission modified its ISR rules in the *International Settlement Rate Order* to allow these services on routes where 50 percent of the traffic is settled at benchmark levels.[45]

The Commission did not subsequently issue its first ISR authorization under these new procedures until April 30, 1998.[46] Additionally, the quarterly reporting obligations did not become effective until this year and only two quarterly reports have thus far been filed, on April 30, 1998 and July 31, 1998. Individual carrier filings are

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45 The Commission found that "[w]ith these reporting requirements" it was "not necessary to adopt AT&T's proposed alternative that we grant [ISR] authorizations . . . on the condition that accounting rates on the route in question are at or below the low end of the benchmarks." *Id.* at 19920.

46 *AT&T Corp., et al.*, Order and Authorization, File Nos. ITC-98-137, ITC-98-138, ITC-98-139, ITC-98-140, ITC-98-141, ITC-98-195, (rel. Apr. 30, 1998) (authorizing ISR services to Luxembourg, Norway, Denmark, France, Germany and Belgium).

confidential and no consolidated report has been published for either quarter. It is thus much too early to assess the effectiveness of these reporting requirements.

Further, any present effectiveness of this safeguard would be largely removed by the adoption of the proposals in the Notice to remove the ISP from all non-dominant carriers and from all carriers on some routes. The removal of the ISP would remove all distinctions between traffic settled under "ISP" and flexibility arrangements and would also largely remove the distinction between "settled" and ISR traffic.

While the blurring of these categories would render the present reporting safeguard highly unreliable, it would not remove the potential bypass harm that it seeks to prevent. Foreign carriers would still seek to increase U.S. outpayments by terminating U.S.-inbound traffic cheaply in the U.S., while maintaining high rates on U.S.-outbound traffic.

3. Other Countries' ISR Policies Do Not Provide A Model For The U.S.

Finally, the fact that other countries may not regulate the provision of ISR in the same manner as the U.S. (Notice, ¶ 38) does not suggest that a change in U.S. policies is required. Other countries' policies inevitably reflect their different circumstances and priorities and are not necessarily applicable to the U.S. In particular, while information concerning settlements in the UK, Sweden and Germany (the countries specifically referenced by the Notice) is limited, and only the UK (and New Zealand) publishes its settlement rates like the U.S., none of these countries appears to have a huge settlements deficit like the U.S.

With their inbound and outbound settled traffic more closely in balance, settlements outpayments are a less serious problem for these countries and the need to prevent bypass activities that may further increase those payments does not give rise to the same concerns as in the U.S. As a further indication of the different sensitivities concerning settlements payments in these countries, none of them, for example, has taken similar actions to the U.S. to require the payment of lower settlement rates to foreign carriers.

IV. THE BOCS SHOULD BE PRECLUDED FROM ACCEPTANCE OF GEOGRAPHICALLY GROOMED TRAFFIC.

Any removal of the ISP, even for arrangements with foreign non-dominant carriers, or approval of secret under 25 percent flexibility arrangements should not extend to those involving the acceptance of geographically "groomed" inbound international traffic by the Bell Operating Companies ("BOCs"). (Notice, ¶ 43.) These carriers should rather be precluded from acceptance of this type of inbound traffic before their access charges are reduced to cost-based levels.

As described in the attached affidavit by Dr. Lehr (pp. 3, 9-10) the BOCs' bottleneck control over local access facilities in the U.S. and above-cost access charges provide potential advantages in the in-region termination of inbound international calls that would allow them to use their market power to subsidize entry into the international market or to engage in strategies to raise other U.S. carriers' costs. Because a BOC incurs a lower cost of access for calls terminating in its region than other U.S. carriers, it can offer foreign carriers a lower inbound rate than other carriers and thus encourage foreign carriers to geographically "groom" their U.S.-bound traffic for cheaper termination by the BOC. This would divert U.S. in-bound traffic from other carriers, thus raising their net settlements payments to foreign carriers. As Dr. Lehr concludes (p. 10), this strategy would offer "an especially attractive way to raise their rivals' costs."

Moreover, there would be a strong community of interest between the BOCs and dominant foreign carriers. Both "have a mutual interest in preserving and/or leveraging their dominant market positions with respect to bottleneck facilities into adjacent markets." Lehr Aff. at 9. Dominant foreign carriers would obtain substantial advantages from the lower termination prices offered by the BOCs as they would be able to avoid their high settlement rates on U.S.-inbound calls. Consequently, such arrangements would further harm the U.S. public interest by increasing the foreign carriers' above-cost settlements profits and U.S. settlement outpayments.

CONCLUSION

For the reasons explained above, AT&T supports the proposal to remove the ISP with foreign carriers that lack market power. AT&T supports the removal of the ISP with all carriers, however, only in markets where settlement rates are at "best practice" levels, or where U.S. carriers are able to terminate traffic through viable ISR arrangements. The Commission should not provide secrecy for under-25 percent flexibility arrangements, and should maintain the existing ISR rules and continue to prohibit grooming arrangements with the Bell Operating Companies.

Respectfully submitted,

AT&T CORP.

By Lawrence Lafaro

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Dated: September 16, 1998

ATTACHMENT 1

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
1998 Biennial Regulatory Review --Reform of the International Settlements Policy and Associated Filing Requirements	)	IB Docket No. 98-148
	)	
Regulation of International Accounting Rates	)	CC Docket No. 90-337
	)	

AFFIDAVIT

OF

WILLIAM H. LEHR

ON BEHALF OF

AT&T CORP.

1. Statement of Qualifications

My name is William H. Lehr. My business address is 94 Hubbard Street, Concord, MA 01742.

I am an associate research scholar in Columbia University's Graduate School of Business, a research associate at the Columbia Institute of Tele-Information, and a consultant to the Massachusetts Institute of Technology Internet Telephony Consortium. My research focuses on the economics of telecommunications and related information technology industries. In addition to my academic research in the area, I have significant professional experience in the telecommunications industry through positions at consulting firms, at MCI, and as an independent industry consultant. Prior to joining the Columbia faculty in 1991, I received my Ph.D. in economics from Stanford University. My M.B.A. (Wharton), M.S.E. (chemical engineering), B.S. (chemical engineering, *cum laude*), and B.A. (European history, *magna cum laude*) degrees are from the University of Pennsylvania. My business address is 94 Hubbard Street, Concord, MA 01742. A copy of my *Curriculum Vitae* with additional details is attached as Attachment 1.

2. Introduction

This affidavit provides comments on the FCC's recent Notice of Proposed Rulemaking (NPRM)[47] regarding modifications to the International Settlements Policy (ISP) (hereafter, the *Settlements NPRM*). Specifically, I have been asked to address the two following changes contemplated by the *Settlements NPRM*: (1) removing filing requirements for flexible settlements agreements involving less than 25% of the inbound or outbound traffic on a route;[48] and (2) relaxing the restriction against Local Exchange Carriers (LECs) from entering into flexible settlement agreements to groom traffic geographically.[49] Both changes would be inconsistent with the goal of promoting increased competition in telecommunications markets, and therefore, harmful to the public interest. My affidavit explains why the asymmetric 25%-rule is arbitrary, harmful to competition, and should be eliminated; while the restriction against LEC grooming agreements is appropriate, necessary to safeguard competition, and should be retained.

The biggest challenge facing international telephone competition is the absence of effective competition in both foreign and US markets for the local access facilities that are essential inputs to both originate and terminate international calls. This lack of competition facilitates the maintenance of settlement rates that are significantly

[47] *Notice of Proposed Rulemaking In the Matter of the 1998 Biennial Regulatory Review Reform of the International Settlements Policy and Associated Filing Requirements*, IB Docket No. 98-148, and Regulation of International Accounting Rates, CC Docket No. 90-337, Federal Communications Commission, Washington, DC, Adopted August 6, 1998 (hereafter, "*Settlements NPRM*").

[48] See *Settlements NPRM*, note 47, *supra*, paragraphs 33-35.

[49] See *Settlements NPRM*, note 47, *supra*, paragraph 43.

above cost, resulting in excessive prices for international telephone service in some markets. Indeed, the FCC's motivation for permitting flexible settlements agreements is, in part, to encourage pressure to reduce these accounting rates closer to the cost of providing service.[50]

The incumbent LEC's in the US and the dominant carriers in foreign markets possess substantial market power over these essential bottleneck origination and termination facilities. In situations where access charges or settlement rates are above cost, both have an ability to protect and leverage their market power over local facilities into international service markets. Regulatory oversight is needed and justified to safeguard competition from these carriers exploiting their market power anticompetitively. Therefore, the restriction against LEC grooming contracts is needed to prevent the LECs from using their market power over local services and the revenues they receive from excessive access charges to subsidize their entry into international competition or to engage in anticompetitive activities aimed at raising rivals' costs.

In contrast, the 25%-rule asymmetrically singles out carriers such as AT&T that happen to have the larger shares of traffic along a particular route. If AT&T possessed market power analogous to the power possessed by the LECs over local access facilities or the foreign carriers over both foreign access and international services, then discriminatory treatment might be warranted (although the choice of 25% as the demarcation point would still be arbitrary). However, this is not the case. The FCC concluded that "AT&T has demonstrated that it lacks market power in international

[50] See *Settlements NPRM*, note 47, *supra*, paragraph 13.

telecommunications markets" and therefore, declared AT&T a non-dominant carrier in 1996.[51]

Applying asymmetric regulatory constraints to a subset of carriers that do not possess market power is anticompetitive. It distorts competition among the remaining participants without market power and strengthens the position of those that actually possess such power. The 25%-rule adversely affects the opportunities and the abilities of carriers such as AT&T to negotiate efficient settlements contracts with foreign carriers. This raises their costs above competitive levels and above those of other participants in the market. The 25%-rule preferentially favors carriers that happen to have a small market share of the outbound traffic on a route, irrespective of their market power in other related markets. Because the incumbent LECs are likely to be below the 25% threshold, they will not face constraints imposed on competitors like AT&T, offering the LECs another opportunity to extend and protect their market dominance over local access markets in the US. By weakening the competitive position of the carrier with the largest share of traffic in the market, the 25% rule strengthens the bargaining position of the dominant foreign carrier.[52]

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[51] See *Order in the Matter of Motion of AT&T Corp. to be declared non-dominant for international service*, Federal Communications Commission, FCC 96-209, May 6, 1996, paragraph 98.

[52] As I explain further below, anything that weakens a strong competitor, strengthens other strong competitors. Foreign carriers that dominate their local markets represent the biggest threat to effective competition. The US carrier with the largest share is likely to have more experience in negotiating with and operating in the foreign carrier's market and hence offer more effective competition than relatively new

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Relaxing regulatory authority for flexible settlement agreements involving less than 25% traffic on a route while retaining restrictions for agreements involving 25% or more does not meaningfully discriminate on the basis of market power, whereas the restriction against a LEC entering into discriminatory grooming contracts does achieve a meaningful distinction. Retaining (and increasing) the distinction in one instance while eliminating it in the other is inconsistent and compounds the error in both cases. In both instances, the effect will be to harm competition leading to reduced pressure to expand customer choice, improve quality, improve efficiency, and reduce prices. This will harm the public interest.

Section 3 and 4 provide further discussion of the 25% rule and the LEC grooming restriction. In Section 5, I offer concluding recommendations.

3. Why the asymmetric 25% rule should be revised

The FCC is contemplating revising its flexibility policy to authorize flexible settlement arrangements with foreign carriers that do not involve more than 25% of the outbound traffic on a route without any disclosure of the identity of the foreign party or the terms of the agreement.

The problem with the FCC's recommendation is that the public disclosure requirements are to be retained for flexibility agreements involving 25% or more of the outbound or inbound traffic. This means, in effect, that only a subset of the participants in the market will be subject to these asymmetric regulatory costs imposed by the public

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entrants that may be willing to negotiate less efficient settlements agreements in order

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disclosure requirements. This asymmetric burden is increased further by the existing requirement that, in addition to public disclosure, an agreement involving 25% or more of the outbound or inbound traffic shall not "contain unreasonably discriminatory terms and conditions."[53] If interpreted to mean that other carriers may take advantage of any rate negotiated by the larger carrier, then this will further reduce incentives for other carriers to negotiate aggressively, as recognized by the FCC.[54] While the interpretation of what might be constituted as "unreasonably discriminatory" is uncertain, these added limitations applied solely to agreements involving 25% or more of the traffic on a route further increases the unit costs of these carriers and further constrains their opportunities and abilities to successfully negotiate efficient settlement arrangements.

The public disclosure and non-discrimination restrictions are motivated by a desire to safeguard the market from anticompetitive behavior. The only proper basis for applying these rules asymmetrically is where the market may be segmented into carriers with market power that pose a threat to competition and those that do not. The choice of 25% is arbitrary. First, market shares, by themselves are inadequate to determine the existence of market power. Second, a share of only 25% is not regarded as indicative of market power. The effect of this threshold is to single out AT&T (and WorldCom, but for smaller proportions of its traffic than for AT&T), because these are the only carriers that

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to purchase market share to penetrate a new foreign market.

[53] See *Settlements NPRM*, note 47, *supra*, paragraphs 34.

[54] See *Settlements NPRM*, note 47, *supra*, paragraph 9.

have a market share in excess of the threshold on any routes, while favoring smaller competitors who are able to shelter 100% of their traffic on all routes, regardless of the market power they may possess in related markets.

This is not appropriate because AT&T no longer possesses market power over international services. AT&T's average market share is less than 60%, not much higher than its share in US domestic long distance markets which have been deemed to be competitive for a long time. Moreover, AT&T's share has declined significantly in recent years. Moreover, as noted earlier, the FCC determined in 1996 that AT&T is no longer a dominant carrier in international telephone service.

Applying these regulatory provisions disproportionately to AT&T harms competition because it reduces its ability to negotiate efficient settlement agreements. A foreign carrier will find it more advantageous to negotiate with competitors who do not face the same public disclosure and non-discrimination restrictions imposed on AT&T. If a foreign carrier does negotiate with AT&T it will have an increased incentive to negotiate a higher settlement rate on the majority of AT&T's traffic that is subject to disclosure as a signal to other potential negotiating partners. In addition to this direct effect of imposing higher settlement costs on AT&T, the asymmetric 25% rule forces AT&T to contend with more cumbersome contracting rules.[55] Together, these result in higher unit costs for the largest participant in the market, thereby reducing competition and pressure on the

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[55] For example, if AT&T elects to enter into a flexible contract for the portion of its traffic that is below the 25% threshold, it will need to negotiate a separate agreement to cover the remaining share of traffic. The costs of negotiating these multiple agreements is uniquely imposed on large carriers.

dominant foreign carrier to reduce the accounting settlement rates. This will reduce AT&T's ability to compete, and is likely to systematically bias settlement rates upwards, especially if there are scale economies associated with competing in foreign markets. Scale economies imply that a firm with a larger market share is likely to have lower costs than smaller competitors. Imposing restrictions that raise the costs for these larger firms means that these scale economies will not be fully reflected in market prices. The asymmetric rules favor potentially less efficient entrants, resulting in higher prices for end-users.

The participants with significant market power are foreign incumbents and LECs. While the latter currently may have small market shares of traffic on international routes, the LECs possess significant market power over the essential local access facilities required to originate or terminate international traffic in the US. The asymmetric rules that harm AT&T and raise its costs favor these LECs and dominant foreign carriers by reducing the competitive threat to LECs and foreign incumbents posed by AT&T both in international markets and in markets for domestic and foreign local access facilities.

These asymmetric provisions applied to larger carriers create the potential for foreign carriers to whipsaw both AT&T and smaller carriers. The foreign carrier will be able to exploit the reduced experience and potentially higher average fixed costs of an entrant to negotiate a more favorable settlement agreement than if AT&T were allowed to compete on an equal basis. The experience of conditions in foreign markets is likely to contribute to the ability of the carrier to negotiate settlement rates that are closer to the foreign carrier's true costs.

In summary, therefore, applying asymmetric regulatory rules that arbitrarily impose higher costs on AT&T is likely to diminish competition in international services and may result in higher prices to consumers and reduced pressure to lower settlement rates toward cost.

4. Why restrictions against LEC grooming contracts should be retained

The FCC does not currently allow LECs to participate in flexible settlements agreements involving groomed traffic based on geographic termination, but the *Settlements NPRM* is contemplating relaxing this restriction. This would be ill-advised. The LECs possess significant market power over essential local access facilities that are required to both originate and terminate calls. As noted earlier, the LECs and dominant foreign carriers have a mutual interest in preserving and/or leveraging their dominant market positions with respect to bottleneck facilities into adjacent markets. The desire to protect their local dominance from competition provides a sufficient incentive to seek to behave anticompetitively in international markets, even *if* their behavior in international markets is not profitable in its own right (*e.g.*, by raising rivals costs). However, such behavior is likely to be profitable for the LECs.

LECs can subsidize their ability to negotiate favorable grooming contracts by taking advantage of access charges that significantly exceed costs. The advantage afforded by these access charge subsidies provides LECs with the ability to compete unfairly against alternative carriers that might otherwise have lower costs than the LEC. Moreover, by distorting the mix of traffic available to other carriers, these grooming contracts may result in higher costs to other carriers as they are forced to accept a mix of traffic with higher termination costs.

The LECs have an incentive to engage in this form of cross-subsidy in order to raise the costs of potential rivals in local access markets, which includes the three US carriers with the largest share in international markets (*i.e.*, AT&T, Worldcom/MCI, and Sprint). In domestic local and long distance markets, there are substantial provisions for regulatory oversight that are intended, in part, to limit a LEC's ability to exploit its market power (*e.g.*, direct regulation by state Public Utilities Commissions, requirements for public filing of tariffs, regulatory prohibition against participating in interLATA services until a LEC satisfies the requirements of Section 271 of the Telecommunications Act of 1996, etc.) that would not apply to geographic grooming contracts entered into under a flexible settlements agreement without disclosure requirements.

The use of flexible geographic grooming contracts would offer the LECs an especially attractive way to raise rivals' costs. The LECs do not carry outbound traffic from their territory and so are not liable for settlements payments that exceed costs for that traffic. Because settlement payments are computed on the basis of net outbound less inbound traffic, the burden of the settlement subsidy associated with above-cost settlement rates would increase more for other carriers with greater amounts of outbound traffic.

The LEC has an incentive to invest in anticompetitive behavior of any form that is likely to preserve the net present value of the excess profits it expects to earn as the de facto monopolist with respect to local access and telephone services. Although it is now two and half years since the passage of the Telecommunications Act of 1996, there is still not effective competition for local telephone or access services in any State. Moreover, no

State has successfully completed implementation of the pro-competitive provisions required by the Act (*e.g.*, CLECs do not have the capability of electronically accessing the incumbent LECs Operations Support Systems at parity).

In summary, therefore, restrictions against the LECs entering into grooming contracts with foreign carriers are needed to protect international competition from anticompetitive behavior by the LECs. These restrictions are likely to be needed as long as the LECs retain significant market power and access charges remain above cost.

5. Conclusions and Recommendations

This affidavit explains why it is both mutually consistent and advisable to (1) eliminate the asymmetric requirement of public disclosure and "no unreasonable discrimination" requirements for flexibility agreements affecting 25% or more of the inbound or outbound traffic to a foreign country; and (2) to retain the restriction against LECs entering into discriminatory settlements grooming contracts. In the former case, the rule discriminates against firms without market power, while in the latter it limits potential anticompetitive behavior by LECs. In both instances, the advocated policy will help safeguard competition and protect the public interest.

FCC DOCKET NO. IB 98-148
AFFIDAVIT OF WILLIAM H. LEHR

I hereby swear, under penalty of perjury, that the foregoing is true and correct, to the best of my knowledge and belief.

William H. Lehr

Subscribed and sworn before me this 15 day of September, 1998.

Channing L. Entwistle

Notary Public

Channing L. Entwistle
NOTARY PUBLIC
My commission exp. Dec. 6, 2000

My Commission expires: ________________

Attachment #1

WILLIAM HERNDON LEHR
Curriculum Vitae

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Biographical Description

Dr. William Lehr is an economist and industry consultant. He is a consultant to the Massachusetts Institute of Technology Internet Telephony Consortium (MIT ITC), an associate research scholar on the faculty of Columbia University's Graduate School of Business, and a research associate at the Columbia Institute of Tele-Information. His fields of specialization and research include industrial organization, political economy, and regulation, especially as these apply to information technology industries. He teaches courses in microeconomics and competitive strategy, including a course on the media and seminars on telecommunications economics. He has published articles on such topics as the effects of industry structure on the quality of telecommunications infrastructure, the economics of standardization, and Internet pricing. He is currently engaged in research on the effects of computer investment on productivity and organizational structure and on Internet industry structure and pricing mechanisms. This latter work is being undertaken in conjunction with the MIT ITC, which is an academic/industry consortium devoted to research on issues related to the convergence of Internet and telecommunications infrastructure.

In addition to his academic research, Dr. Lehr provides litigation, economic, and business analysis consulting services for firms in the information technology industries. Over the past three years, he has worked extensively providing expert testimony and litigation support services in regulatory proceedings before the FCC and numerous state commissions associated with issues related to the implementation of the Telecommunications Act of 1996.

Dr. Lehr holds a PhD in Economics from Stanford (1992), an MBA from the Wharton Graduate School (1985), and MSE (1984), BS (1979) and BA (1979) degrees from the University of Pennsylvania.

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M.S.E., Chemical Engineering, University of Pennsylvania, 1984.
B.S., Chemical Engineering, *cum laude*, University of Pennsylvania, 1979.
B.A., European History, *magna cum laude*, University of Pennsylvania, 1979.

Academic Honors: Graduate Student Research Award, Telecommunications Policy Research Conference, 1991; Lynde and Harry Bradley Foundation Fellowship, 1990; Stanford Fellowship, 1987

PROFESSIONAL EXPERIENCE

Graduate School of Business, Columbia University (New York, NY), Associate Research Scholar of Finance and Economics, 1997-present; Assistant Professor of Finance and Economics, July 1991 to December 1996.

Internet Telephony and Interoperability Consortium, Center for Technology, Policy and Industrial Development, Massachusetts Institute of Technology (Cambridge, MA), Consultant, January 1997-present.

RAND Corporation (Santa Monica, CA), Graduate Student Intern, Summer 1990.

Economic Analysis Group, Ltd. (Washington, DC), Senior Consultant, 1986-1987.

"Baghdad 2000" Master Development Plan (Baghdad, Iraq), Economist and Systems Analyst, 1985-1986.

M.C.I. Telecommunications (Washington, DC), Manager of Financial Analysis, 1985; Senior Financial Analyst, 1984.

Office of Management and Budget, National Security Division (Washington, DC), Graduate Student Intern, Summer 1983.

Putnam, Hayes and Bartlett (Cambridge, MA), Research Associate 1980-1982.

TEACHING EXPERIENCE

Internet Economics 101, 1998
Economics of Telecommunications Pricing, 1996, 1997
Economics and Strategy in Media Industries, 1993-1995
Economics of Strategic Management, 1993

Managerial Economics, 1991-1995
Theory of the Firm (teaching assistant for Paul Milgrom), 1989

PAPERS and PUBLICATIONS

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"Economics of Anticipatory Standard Setting", paper presented to the European Association of Research in Industrial Economics (E.A.R.I.E.) Conference, Chania, Crete, September 1994.

"Political Economics of Voluntary Standard Setting", working paper, January 1992.

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I, Karen Kotula, do hereby certify that on this 16th day of September, 1998 a copy of the foregoing " Comments of AT&T Corp." was mailed by U.S. first class mail, postage prepaid, upon the parties on the attached service list:

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